

**DEPARTMENT OF STATE REVENUE  
LETTER OF FINDINGS NUMBER: 95-0384  
INDIANA STATE GROSS INCOME TAX  
For Years 1987, 1988, and 1989**

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**ISSUES**

**I. Gross Income Tax Base for 1987-89 / Exclusion of Sales Under the Interstate Commerce Clause Exemption:**

**Authority:** IC 6-2.1-2-2; IC 6-2.1-3-3; IC 6-8.1-5-1(b); D.H. Holmes Co. v. McNamara, 486 U.S. 24 (1988); Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232 (1987); Reynolds Metals Co. v. Indiana Dept. of State Revenue, 433 N.E.2d 1 (Ind. Ct. App. 1982); Mueller Brass Co. v. Indiana Dept. of Revenue, 265 N.E.2d 704 (Ind. 1971); 45 IAC 1-1-120(1)(b); IAC 1-1-120(2); IAC 1-1-120(2)(a); IAC 1-1-120(2)(c); IAC 1-1-120(2)(d).

Taxpayer protests the imposition of the state's Gross Income Tax on the proceeds of sales made between certain of taxpayer's out-of-state subsidiaries.

**II. Gross Income Tax Base for 1987-89 / Taxability of the Sales of Goods Temporarily Stored Within Indiana.**

**Authority:** IC 6-2.1-2-2(a)(1); IC 6-8.1-5-1(b); 45 IAC 1-1-118; 45 IAC 1-1-119; 45 IAC 1-1-119(2)(b).

Taxpayer protests the imposition of the Gross Income Tax on sales of its products, temporarily stored at taxpayer's Indiana location, for use by the taxpayer at its out-of-state locations.

**STATEMENT OF FACTS**

Taxpayer provides services, products, and systems for the movement and management of information. Taxpayer also provides installation, maintenance, and repair services for its products and communication systems. Taxpayer provides interstate and intrastate interLATA (Local Access and Transport Area) long distance telecommunications

services throughout the United States among those geographical areas which been termed Local Access and Transport Areas. In addition, taxpayer provides interstate telecommunications services from areas outside the continental United States.

Nine different constituent companies fall within the ambit of the audit report. The audit maintained that two of those nine constituent subsidiaries not only had an extensive business presence in Indiana, but also offered comprehensive support programs for equipment installation, engineering, maintenance, and leasing. A complete listing of Indiana business locations, as of September 1992, included 127 separate business sites. Taxpayer declined to specify which constituent company utilized any particular location but did acknowledge that the affiliated companies shared a number of the 127 locations.

**I. Gross Income Tax Base for 1987-89 / Exclusion of Sales Under the Interstate Commerce Clause Exemption.**

**DISCUSSION**

It was the auditor's position that all product sales were connected with taxpayer's Indiana locations and/or were attributable to the "bundle of corporate activity" which generated the sales. Two of taxpayer's subsidiary corporations (hereinafter "technology subsidiary" and "information subsidiary") not only had a major business presence in Indiana, but also offered extensive support programs for installation, engineering, maintenance, and equipment leasing related to the taxpayer's out-of-state activities. Technology subsidiary provided engineering, design and installation support for the products sold by information subsidiary. Technology subsidiary also manufactured products and oversaw the printing of technical manuals. Information subsidiary manufactured, marketed, leased and maintained various telecommunications and computer products. It also operated retail outlets for the taxpayer's consumer products. (Taxpayer's information subsidiary and technology subsidiary have since merged into the parent company, but the subsidiary companies remain identifiable as separate business units.) As a result, the auditor deemed that all product sales were subject to the Gross Income Tax.

Taxpayer argued that the auditor improperly included within its assessment product sales which should have been excluded from the Indiana Gross Income Tax base under the Interstate Commerce exemption. Taxpayer explained that the "vast majority" of sales by technology subsidiary, included in audit's Gross Income Tax determination, resulted from orders placed by a third subsidiary. Those orders were received and approved at taxpayer's offices in Illinois with payment received by a taxpayer subsidiary located in Georgia. According to the taxpayer, 95 percent of those orders ultimately resulted in shipment from various taxpayer locations outside of Indiana to taxpayer locations outside of Indiana. Therefore, as to those out-of-state shipments, technology subsidiary performed no support, installation, engineering, maintenance, or leasing services within Indiana. Taxpayer concluded that technology subsidiary's activity, with respect to the specific out-of-state to out-of-state transactions, did not give rise to the requisite level of nexus necessary to impose the Indiana Gross Income Tax.

Taxpayer is required to carry its burden of proof by demonstrating that the proposed tax has been incorrectly assessed. IC 6-8.1-5-1(b) states in relevant part that “[t]he notice of proposed assessment is prima facie evidence that the department’s claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.” In addition, because the taxpayer asserts that the sales in question are not subject to the Gross Income Tax by virtue of the protection afforded under the Interstate Commerce Clause (U.S. Const. art. I, § 8), taxpayer, as “[t]he party claiming an interstate commerce exemption, or that the danger that he is subject to the risk of multiple taxation, bears the burden of establishing such facts, and any doubt should be resolved in favor of the tax.” Reynolds Metals Co. v. Indiana Dept. of State Revenue, 433 N.E.2d 1, 8 (Ind. Ct. App. 1982).

The Indiana Gross Income Tax (IC 6-2.1-0.6 to 6-2.1-8-7) “is imposed upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident of Indiana.” IC 6-2.1-2-2 To assure that only funds properly subject to a state tax are subject to the Gross Income Tax, IC 6-2.1-3-3 provides that “[g]ross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign county is exempt from Gross Income Tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution.” IC 6-2.1-3-3 was passed in recognition of the fact that the Commerce Clause requires that Indiana not unduly burden commerce between the states. Therefore, Indiana may not impose a tax that discriminates against interstate commerce in favor of intrastate commerce. “While a state may impose a tax burden that is reasonable in light of the incidence of commercial contact by the taxpayer with [the state], a tax system which may produce a multiple taxation burden is proscribed.” Mueller Brass Co. v. Gross Income Tax Division, Indiana Dept. of Revenue, 265 N.E.2d 704, 717 (Ind. 1971).

The taxpayer argues that the sales in question fell within the protection afforded by the Interstate Commerce Clause. More specifically, taxpayer cites to 45 IAC 1-1-120(1)(b) which exempts from the Gross Income Tax those “[s]ales made by a nonresident who has a business or business activities within the State, but the situs or activities are not significantly associated with the sales, and the goods are shipped directly to the buyer upon receipt of a prior order.” In contrast, audit cited 45 IAC 1-1-120(2) which states, as an example of sales subject to the Gross Income Tax, those “[s]ales made by a nonresident, when the seller has established a business situs within the State, and the sales originated from, were channeled through, or were otherwise connected with the Indiana situs.” 45 IAC 1-1-120(2)(a). Audit also cited 45 IAC 1-1-120(2)(c) which subjects to the Gross Income Tax those “[s]ales made by nonresidents where the goods are shipped directly to the buyer from an out-of-state business location, but where the seller is conducting substantial business activities within the State which were connected with the state.” Audit also found relevant 45 IAC 1-1-120(2)(d) which imposes the tax on those “[s]ales made by nonresidents where the goods are shipped by the seller directly from an out-of-state location to the buyer, but where the seller had an employee or employees working within the State who were responsible for maintaining valuable and

long-lasting contractual relations between seller and buyer, from which relations the sales arose.”

The Supreme Court rejected the notion that every transaction in interstate commerce itself could not be taxed by the states but recognized that, with certain restrictions, interstate commerce may be subjected to state taxes. D.H. Holmes Co. v. McNamara, 486 U.S. 24, 30-31 (1988).

The Supreme Court has stated that “the crucial factor governing nexus is whether the activities performed in [the] state are significantly associated with the taxpayer’s ability to establish and maintain a market in [the] state for the sales.” Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232, 250 (1987). Although it is undisputed that taxpayer’s technology subsidiary maintains a business presence within Indiana, the transactions in dispute are those which occur between an out-of-state location and a second out-of-state location. Absent evidence that the technology subsidiary’s Indiana activities are in any way related to those exclusively out-of-state transactions, no nexus can be found.

Assuming the factual assertions regarding taxpayer’s purported out-of-state to out-of-state transactions are correct and verifiable, the proposed tax assessment on those particular transactions is inappropriate. Therefore to the extent that taxpayer’s transactions occurred between one out-of-state location and another out-of-state location, taxpayer’s protest is sustained. A supplemental audit is requested in order to determine specifically which of taxpayer’s transactions are subject to this determination and to adjust the taxpayer’s assessment accordingly.

### **FINDING**

Taxpayer’s protest is sustained subject to the findings of a supplemental audit.

## **II. Gross Income Tax Base for 1987-89 / Taxability of the Sales of Goods Temporarily Stored Within Indiana.**

### **DISCUSSION**

Taxpayer protests the auditor’s determination that certain product sales, made from goods temporarily located at taxpayer’s Indiana facility, to taxpayer’s out-of-state subsidiaries, are subject to the imposition of the Gross Income Tax.

As a general rule, under the provisions of the Interstate Commerce Clause, the income from the sales of goods to out-of-state purchasers is exempt from the imposition of state tax. 45 IAC 1-1-118, 119. A general exception to that rule occurs when the sales are completed in Indiana. 45 IAC 1-1-119. As an example, 45 IAC 1-1-119(2)(b) provides that “[s]ales to nonresidents where the goods are accepted by the buyer or he takes actual delivery within the State” are subject to the Indiana Gross Income Tax.

Taxpayer protests the imposition of tax on sales of its goods, temporarily stored within Indiana, from taxpayer's Indiana technology subsidiary to certain of its out-of-state operating subsidiaries. Unfortunately, the taxpayer provides no factual or legal basis upon which to predicate this particular portion of its protest. Absent a more substantive basis upon which to make a decision, the Department is left with (1) IC 6-2.1-2-2(a)(1) which imposes the Gross Income Tax upon "the entire taxable gross income of a taxpayer who is a resident or domiciliary of Indiana;" (2) the provisions of 45 IAC 1-1-119 which permit the imposition of the Gross Income Tax on sales to out-of-state buyers when "the sales are completed in Indiana;" and (3) IC 6-8.1-5-1(b) which states the "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid." That same regulatory section continues by imposing on taxpayer "[t]he burden of proving that the proposed assessment is wrong . . . ." Id.

### **FINDING**

The taxpayer's protest is respectfully denied.